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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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**COMMISSIONERS**

MIKE GLEASON, Chairman  
WILLIAM A. MUNDELL  
JEFF HATCH-MILLER  
KRISTIN K. MAYES  
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF  
CHAPARRAL CITY WATER COMPANY FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES FOR UTILITY  
SERVICE BASED THEREON.

DOCKET NO. W-02113A-04-0616

**STAFF'S REPLY BRIEF**

The Staff of the Arizona Corporation Commission hereby responds to the Closing Brief of Chaparral City Water Company ("Chaparral City" or "Company"), which was filed on March 5, 2008. Staff recommends that the Commission 1) adopt a fair value rate of return ("FVROR") for the Company that falls between 6.34-6.54 percent and 2) deny the Company's request to recover additional rate case expense. Nothing presented by the Company's Closing Brief warrants a change in Staff's positions.

**I. STAFF'S EVALUATION OF THE PROPER TREATMENT FOR THE FAIR VALUE INCREMENT FALLS WITHIN THE SCOPE OF THE COURT OF APPEALS' MANDATE.**

The Company begins its brief by arguing that Staff is somehow foreclosed from offering an alternative to the "backing-in" method that the Commission previously employed to adjust the WACC. Chaparral Br. at 2. The Company claims that the Commission "may not reopen or reconsider issues that were not raised on appeal." Chaparral Br. at 1. The Company then claims that Staff is attempting to relitigate the capital structure issues by substituting a new, hypothetical capital structure for the one that was approved by the Commission in Decision No. 68176. Chaparral Br. at 2. This is not a fair characterization of Staff's approach.

As explained in Staff's opening brief, Staff's two alternatives provide a means to adjust the WACC for application to a FVRB; they do not attempt to redo the capital structure underlying the

1 WACC. Staff's Op. Br. at 3-4. The concept of a downward adjustment to the WACC for application  
2 to a FVRB is consistent with financial theory.

3 It is clear that the cost of capital will differ from the fair rate of return  
4 if the definition of rate base is not consistent with the definition of  
5 total capital used in calculating the cost of capital. The fair rate of  
6 return will vary, depending upon the method used in calculating the  
7 rate base. If an original cost rate base is used, the fair rate of return  
8 will equal the weighted average cost of the utility's cost of debt,  
preferred stock, and equity, with each of these cost rates being  
calculated on the basis of original cost. Conversely, in order for the  
utility to be given an opportunity to earn the same dollar cost of capital  
from a fair value rate base, the appropriate fair return will differ from  
that which would be applied to an original cost rate base.

9 Ex. S-R2 at 32. In Decision No. 68176, the Commission accomplished this downward adjustment by  
10 applying the so-called "backing-in" method. Although the Court of Appeals subsequently  
11 determined that the "backing-in" method is not consistent with the Arizona Constitution, the Court  
12 did not prescribe the method by which the Commission must determine the FVROR, did not criticize  
13 the Commission's conclusion that the Company's method would lead to an excessive rate of return,  
14 and did not set aside the Commission's determination that it is necessary to adjust the WACC in  
15 order to determine an appropriate rate of return. See Ex. A-R13, *Chaparral City Water Co. v.*  
16 *Arizona Corp. Comm'n*, 1 CA-CC 05-0002 at 13-14, ¶ 17 (Ariz.App. 2007) (Unpublished).

17 The present inquiry before the Commission is *how* to accomplish the downward adjustment to  
18 the WACC—not *whether* to do so. Staff witness Parcell recommended modifying the WACC,  
19 through the capital structure, to recognize the "fair value increment," i.e., the difference between the  
20 FVRB and OCRB. By identifying this "fair value increment," Staff was able to suggest a "fair value  
21 capital structure" by which to then determine the FVROR. Ex. S-R5, Parcell Direct at 4-5.

22 The Company's argument on this issue is somewhat surprising, as it appears to be inconsistent  
23 with other portions of its brief. Specifically, the Company appears to acknowledge that the issue  
24 presented herein is how to treat the Fair Value Increment. See Chaparral Br. at 15. The Company  
25 suggests that the Commission should treat the Fair Value Increment as if it is supported either  
26 entirely by equity or by the Company's overall capital structure. Chaparral Br. at 13-17. It is highly  
27 inconsistent for the Company to suggest specific ratemaking treatment for the Fair Value Increment,  
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1 but to simultaneously claim that other parties are foreclosed from doing so. In addition, the Company  
2 is also using this proceeding to seek additional rate case expense, an issue that was never mentioned  
3 before the Court of Appeals.

4 Finally, the Company's effort to foreclose the Commission from considering the analyses  
5 offered by other parties overlooks both the breadth of the court's mandate and the plenary ratemaking  
6 authority of the Commission. The court's mandate provides that the Commission shall conduct such  
7 proceedings "as shall be required to comply with the decision of this court . . . ." Mandate,  
8 *Chaparral City Water Co. v. Arizona Corp. Comm'n*, No. 1 CA-CC 05-0002 (May 29, 2007). The  
9 purpose of this proceeding is to establish just and reasonable rates, and the Commission has exclusive  
10 and plenary authority over ratemaking. *See, e.g.,* Ariz. Const. art. XV, § 3; *Arizona Corp. Comm'n v.*  
11 *State ex rel. Woods*, 171 Ariz. 295, 297, 830 P.2d 807, 816-18 (1992). These sources, in  
12 combination, would appear to permit the Commission to consider the entirety of the evidence before  
13 it and to use this evidence to fashion an appropriate disposition of this case.

14 **II. STAFF'S PROPOSED ALTERNATIVES FOR THE FVROR ARE SUPPORTED BY**  
15 **BOTH THE FACTS AND THE LAW, AND THE COMMISSION SHOULD**  
16 **THEREFORE ADOPT A FVROR THAT IS CONSISTENT WITH STAFF'S**  
**RECOMMENDATIONS.**

17 At the outset, it may be helpful to summarize the various points on which Staff and the  
18 Company appear to be in agreement. First, both parties appear to agree that the Commission is  
19 required to find the fair value of the Company's plant devoted to public service and to use that value  
20 as a rate base for purposes of setting the Company's rates. *Simms v. Round Valley Light and Power*  
21 *Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956). Second, in this case, the parties are not disputing—  
22 at least as between Staff and the Company—the numerical fair value of the Company's plant. Smith  
23 Direct at 12. Finally, the Company appears to recognize that the Commission, in this proceeding,  
24 must determine the ratemaking treatment of the "fair value increment" for purposes of determining  
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1 the Company's FVROR.<sup>1</sup> Chaparral Br. at 13-17. It is at this point, however, that the parties' views  
2 begin to substantially diverge.

3       **A. The Commission, Pursuant To Its Constitutional Ratemaking Authority, Has**  
4       **Exclusive And Plenary Power To Determine The Ratemaking Treatment Of The**  
5       **Fair Value Increment.**

6       The Company appears to argue that the Commission is required as a matter of law to treat the  
7 fair value increment as if it were supported either entirely by equity or by the Company's overall  
8 mixture of capital.<sup>2</sup> Chaparral Br. at 12-18. In support of its argument, the Company relies upon a  
9 North Carolina case, *State ex rel. Utilities. Comm'n v. Duke Power Co.*, 206 S.E.2d 269 (1974), in  
10 which the court determined that North Carolina's ratemaking statutes required their commission to  
11 treat the Fair Value Increment as equity. The Company then concludes that this same result is  
12 appropriate for Arizona, arguing that

13               North Carolina's statute governing rate-making required that "the  
14               Commission shall fix rates which will enable a well managed utility to  
15               earn a 'fair rate of return' on the 'fair value' of its properties 'used and  
16               useful' in rendering its service." Thus, North Carolina law was  
17               analogous to Arizona law.

18       Chaparral Br. at 15 (citations omitted). Because of the Commission's status as a constitutionally  
19 created entity, it is far from clear that Arizona law is analogous to that of North Carolina.

20       It is instructive to review the text of the *Duke Power* case:

21               [t]he legislative mandate is that the Commission shall fix rates which  
22               will enable a well managed utility to earn a 'fair rate of return' on the  
23               'fair value' of its properties 'used and useful' in rendering its service.

24       *Duke Power*, 206 S.E.2d at 276. This summary of the "legislative mandate" follows roughly five  
25 paragraphs in which the court reproduces the relevant—and lengthy—North Carolina statutes that  
26 govern ratemaking. *Id.* The *Duke Power* opinion is clearly routed in statutory construction. This is  
27 in stark contrast to Arizona law, which places ratemaking authority exclusively with the Commission.

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<sup>1</sup> The "fair value increment" can be defined as that part of the capital structure that represents the  
difference between the fair value rate base ("FVRB") and the original cost rate base ("OCRB"). See  
Ex. S-R5, Parcell Direct at 5: 8-17.

<sup>2</sup> The Company states that its proposed FVROR of 7.6 percent is consistent with the second of these  
two alternatives. Chaparral Br. at 17.

1 In North Carolina, as in most other states, the state's police power regarding ratemaking  
2 resides with the legislature. The North Carolina court in *Duke Power* and in previous cases dealt  
3 with the interpretation of a state statute and accordingly concluded that the statute required its  
4 Commission to treat the Fair Value Increment as equity. See 206 S.E.2d at 396; *Utilities Comm'n v.*  
5 *Tel. Co.*, 189 S.E.2d 705, 720 (1972). By contrast, Arizona's Constitution places the state's  
6 ratemaking authority exclusively with the Commission. *Arizona Corp. Comm'n v. State ex rel.*  
7 *Woods*, 171 Ariz. 286, 297, 830 P.2d 807, 818 (1992). While other states determine a variety of  
8 substantive ratemaking questions—such as how to treat the fair value increment—by statute, in  
9 Arizona, it is the Commission, pursuant to its exclusive constitutional authority, that determines such  
10 questions. In sum, the treatment of the “fair value increment” is a “necessary step in ratemaking” and  
11 therefore falls within the Commission's exclusive jurisdiction. See *Woods*, 171 Ariz. at 294, 830  
12 P.2d 807, 815.

13 The Company also argues that Article XV, Section 14 of the Arizona Constitution (the fair  
14 value provision) requires the Commission to treat the Fair Value Increment as if it were supported  
15 either by equity or by the overall capital structure. This is an innovative argument, considering that  
16 Section 14 does not mention the term “Fair Value Increment” and does not set forth any method for  
17 determining the fair value rate of return. To state the obvious, Section 14 concerns the determination  
18 of “rate base,” as numerous Arizona cases hold. *Simms* at 15, 294 P.2d 378, 380; *Scates v. Arizona*  
19 *Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978); *Arizona Corp. Comm'n v. Arizona Public*  
20 *Service*, 113 Ariz. 368, 555 P.2d 326 (1976); *Ethington v. Wright*, 66 Ariz. 382, 189 P.2d 209 (1948);  
21 *US West Comm. Inc. v. Arizona Corp. Comm'n*, 201 Ariz. 242, 34 P.3d 351 (2001); *Litchfield Park*  
22 *Service, Co. v. Arizona Corp. Comm'n*, 178 Ariz. 431, 874 P.2d 988 (App. 1994). The text of Section  
23 14, in its entirety, is quite limited:

24 The Corporation Commission shall, to aid it in the proper discharge of  
25 its duties, ascertain the fair value of the property within the State of  
26 every public service corporation doing business therein; and every  
27 public service corporation doing business within the State shall furnish  
28 to the Commission all evidence in its possession, and all assistance in  
its power, requested by the Commission in aid of the determination of  
the value of the property within the State of such public service  
corporation.

1 Ariz. Const. art. XV, § 14. The specific terms of this provision do not—and should not be interpreted  
2 to—control the Commission’s determination of an appropriate FVROR. To attempt to extend it to  
3 dictate how the Commission determines the FVROR—and specifically how the Commission must  
4 treat the Fair Value Increment—simply goes too far.

5 In summary, then, the Commission should reject the Company’s attempt to limit the  
6 Commission’s alternatives for determining the appropriate ratemaking treatment for the fair value  
7 increment. By these arguments, the Company attempts to imply that the Commission is required, as a  
8 matter of law, to adopt the WACC of 7.6 percent as the FVROR, despite the Commission’s previous  
9 conclusion in Decision No. 68176 that this result would lead to excessive rates.

10 C. **It Is Doubtful In The Extreme That Arizona’s Constitutional Framers Intended To**  
11 **Require, As A Matter Of Law, That The Commission Adopt Rates That Will**  
12 **Produce An Excessive Rate Of Return.**

13 1. **The likely result of adopting the Company’s proposed methodology will be**  
14 **higher rates.**

15 In Decision No. 68176, the Commission determined that the Company’s proposed  
16 methodology will produce excessive rates:

17 *The rate of return methodology* and resulting revenue increase  
18 proposed by Chaparral City would produce an excessive return on  
19 FVRB.

20 Decision No. 68176 at 27-28 (emphasis added). If one were to use the WACC as the FVROR  
21 applicable to a FVRB, as the Company proposes, it is beyond question that higher rates will always  
22 result in circumstances in which the Company’s FVRB is greater than its OCRB. This principle was  
23 clearly established at the hearing by witnesses from all three parties. For example, Company witness  
24 Zepp acknowledged that this is the arithmetic result.

25 Q. Would you agree that if the company’s request were approved  
26 in this proceeding the company will have higher revenues and higher  
27 income than would be the case if its rates were set using either of  
28 Staff’s proposals?

A. I agree.

Q. And it would follow that the company’s shareholders would  
earn a higher rate of return under the company’s proposal than under  
either of the Staff proposals, do you agree with that?

1 A. I agree that if we have a higher rate of return, multiplied by the  
same rate base, you are going to get higher operating income. I agree.

2 Q. Would you agree that if the company's 7.6 proposal were used  
3 as the fair value rate of return, that the company would have higher  
revenues and higher income than would be the case if its rates were set  
4 under the so-called backing in method?

5 A. Yes.

6 Q. Would you agree that in Arizona this would be the result for  
any utility that has a fair value rate base that is higher than its original  
7 cost rate base?

8 A. I will agree with you that generally speaking if you take a  
number 7.6 and multiply it by a smaller rate base you get a smaller  
9 operating income than if you multiply it by a larger rate base.

10 Tr. at 236-38. Staff witness Parcell discussed the likely effects upon other utilities.

11 I think Mr. Smith said before that the differential between the book  
value and the fair value of APS is the basis for the \$1.6 billion. If this  
12 was applied to APS, the extra dollars, the impact on rates would be  
almost staggering, I would think. \$1.6 billion times any incremental,  
13 that's a lot of zeros.

14 Tr. at 358. And in his prefiled testimony, RUCO witness Johnson recognized this likely result. *See*  
15 Ex R-R2, Johnson Surrebuttal at 5-6. The parties therefore unanimously conclude that rates will be  
16 higher under the Company's proposed method than they would be under the "backing-in" method in  
situations where a utility's FVRB exceeds its OCRB.

17 Based upon the evidence at the hearing, the Commission can conclude that Arizona utilities  
18 generally have higher FVRBs than OCRBs. In its brief, the Company appears to claim that FVRB  
19 will generally exceed OCRB for water utilities, due to the inflationary pressures that water companies  
20 allegedly experience. Chaparral Br. at 39-40. The Company argues that there will be instances in  
21 which various utilities will have OCRBs that exceed their FVRBs, thereby resulting in lower rates  
22 under the Company's version of the fair value standard. Tr. at 244-46. Staff witness Smith,  
23 however, testified that FVRB has exceeded OCRB in the Arizona cases in which he has participated.  
24 Tr. at 322-23. As one can see from Mr. Smith's resume, he has extensive Arizona experience,  
25 especially in electric and gas cases. Ex S-R3, Smith Direct at RCS-1. Under these circumstances in  
26 which the FVRBs of Arizona utilities generally exceed their OCRBs, Arizona ratepayers can look  
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1 forward to generally higher rates across the board if the Commission were to routinely adopt the  
2 Company's proposal for determining the FVROR.

3       There is no reason to conclude that higher rates would be justified or that Arizona regulation  
4 has not produced reasonable rates. Tr. at 358-359. As Staff witness Parcell stated, "it is not a  
5 situation where the whole system is not working, because the companies have survived and been  
6 around for a long time . . . ." Tr. at 359. Furthermore, a system that produces comparably higher  
7 rates would appear to conflict with the most basic tenets of rate regulation, i.e., that a utility should be  
8 provided with rates that will allow it an opportunity to earn a return that is comparable to those of  
9 similarly situated enterprises. Ex. S-R6, Parcell Surrebuttal at 7-8; Tr. at 359-60. The Company's  
10 proposal, if universally applied, would produce windfall returns to shareholders. Ex S-R5, Parcell  
11 Direct at 6-8; Ex. S-R6, Parcell Surrebuttal at 20; *See also* Ex. S-R3, Smith Direct at 5; Ex. S-R4,  
12 Smith Surrebuttal at 33. Such a result is clearly unfair and would not serve the public interest.

13                   **2.       The Company's version of the fair value standard has never been adopted**  
14                   **in Arizona.**

15       The Company seems to be implying that such resulting higher rates are required as a matter of  
16 Arizona law. According to the Company,

17                   [T]he difference between OCRB and FVRB—the FV Increment—  
18                   should be recognized in determining the rate of return *by adjusting the*  
19                   *utility's equity balance to include the FV Increment and then using the*  
20                   *adjusted equity balance to determine the cost of capital.* That  
21                   approach complies with the fair value standard by allowing the utility  
22                   and its equity investors to benefit from increases in the value of the  
23                   property devoted to public service, but also requiring the utility and its  
24                   equity investors to bear the risk of obsolescence and other loss of  
25                   property value, which would result in a downward adjustment to the  
26                   utility's equity balance.

27       Chaparral Br. at 16 (emphasis added). Under this reasoning, when a utility's FVRB is greater than its  
28       OCRB, the fair value standard would require the Commission to set rates that are higher than those  
29       that might be obtained under the original cost approach.<sup>3</sup> This result-oriented approach is unlikely to  
30       be the result that was contemplated by Arizona's constitutional framers.

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32       <sup>3</sup> By contrast, the Company appears to argue that, when a utility's FVRB is less than its OCRB, the  
33       fair value standard conversely requires the Commission to set rates that are lower than those that  
34       might be obtained under the original cost approach. *See* Chaparral Br. at 16.



1 The concept of fair value began as a federal constitutional standard, *see Duke Power*, 206  
2 S.E.2d at 276, citing *Smyth v. Ames*, 169 U.S. 466 (1898), and it is likely that Arizona's constitutional  
3 framers, in adopting Section 14, envisioned that the Commission would thereby be empowered to set  
4 rates as low as would be consistent with federal due process requirements. *See Duke Power*, 206  
5 S.E.2d at 276. This intent is not surprising when one considers the populist leanings of Arizona's  
6 constitutional framers:

7 The founders expected the Commission to provide both effective  
8 regulation of public service corporations and *consumer protection*  
9 *against overreaching by those corporations*. The progressive and  
10 labor forces, two strong ideological influences at the constitutional  
11 convention, combined to promote strong commission authority to  
12 regulate corporations, although the strongest power ultimately was  
13 limited to regulation of public service corporations.

14 *These ideological groups shared a strong distrust of corporate*  
15 *powers*. As one influential framer . . . argued, "in almost every state . .  
16 . corporations have altogether too much influence in the [state's]  
17 direction and control.

18 *Woods* at 291, 830 P.2d 807, 812 (quoting *Journal of the Constitutional Convention of Arizona* 435  
19 (Cronin comp. 1925)) (emphasis added) (citations omitted). The Company's proposal, which would  
20 provide a substantial bonus to utility shareholders,<sup>4</sup> is inconsistent with this history. Furthermore,  
21 Arizona law does not prescribe a method for determining the FVROR, but instead assigns that task  
22 exclusively to the Commission.

23 **3. The Company's criticisms of Staff's first alternative appear to be aimed**  
24 **at the result, as opposed to the method.**

25 Actually, both Staff and the Company use the same general outline to approach the FVROR  
26 issues: both begin with the WACC and both discuss how to treat the Fair Value Increment in terms of  
27 the applicable cost-rate. The Company suggests that the Fair Value Increment should be treated as if  
28 it is supported either entirely by equity or by the Company's overall capital structure, and arrives at a  
proposed FVROR of 7.6 percent.<sup>5</sup> Chaparral Br. at 13-17. Staff, by contrast, bases its

<sup>4</sup> See Ex. S-R5, Parcell Direct at 6.

<sup>5</sup> The Company's proposed FVROR, which is 7.6 percent, is based upon the second of these two  
alternatives. Chaparral Br. at 17.

1 recommendations upon an analysis of the actual costs underlying the Fair Value Increment, and  
2 proposes two alternatives that result in a range of 6.34-6.54 percent for the FVROR. Ex. S-R5,  
3 Parcell Direct at 5-6, 9; Ex. S-R6, Parcell Surrebuttal at 12. Because Staff's analysis is based upon a  
4 consideration of the Company's actual costs, Staff believes that its results are more reasonable than  
5 those offered by the Company. *Id.*

6 The Company argues that Staff's first alternative produces results that are identical to the  
7 "backing-in" method and is therefore unlawful. Chaparral Br. at 33. Staff acknowledges that, in the  
8 context of this remand proceeding, the first alternative produces the same result in an algebraic sense  
9 as the "backing-in" method. *See* Ex. A-R14. However, this does not mean that the two methods will  
10 always produce identical results. *Id.* Furthermore, the fact that the results are similar (or even  
11 identical) does not mean that Staff's first alternative is deficient as a matter of law. The Court's  
12 criticism of the "backing-in" method was based upon its conclusion that the Commission was not  
13 considering the Company's FVRB, but was instead determining rates based upon OCRB and then  
14 merely engaging in a "superfluous mathematical exercise" to determine the corresponding FVROR.  
15 *See* Ex. A-R13, *Chaparral City* at 13-14, ¶ 17. As Staff witness Parcell noted,

16 [f]rom a financial and economic perspective, it does not matter whether  
17 the ratemaking impact of using Staff's first alternative is nearly the  
18 same, or even exactly the same, as the "backing-in" method. Chaparral  
19 City seems to conclude that these nearly identical results mean that  
20 Staff's first alternative is a superfluous mathematical exercise, as the  
21 court used that term in the *Chaparral City* case. I do not agree with  
22 this conclusion because Staff's first alternative expressly considers how  
23 to independently calculate and determine the FVROR. By contrast, my  
24 understanding, from a non-legal perspective, is that the court in the  
25 *Chaparral City* case perceived the Commission to be determining rates  
26 by using an OCRB, and then determining the FVROR as a fall-out  
27 number, i.e., without any independent analysis. This is not the case  
28 with either of Staff's proposals.

23 Tr. at 340-41. For the reasons stated in the direct and surrebuttal testimonies of Staff witness Parcell,  
24 Staff's first alternative is supported by established principles of economics and finance and is  
25 therefore an appropriate method for determining the Company's FVROR. *See* Ex. S-R5, Parcell  
26 Direct; Ex. S-R6, Parcell Surrebuttal. Furthermore, no Arizona case holds that the Commission  
27 cannot consider modern principles of economics and finance, including those related to original cost,  
28

1 when determining a Company's FVROR.<sup>6</sup>

2       Nonetheless, if the Commission were to conclude that it is required by law to set rates that are  
3 higher than would result under an original cost approach, the Commission should nonetheless reject  
4 the Company's proposed FVROR of 7.6 percent. In these circumstances, the Commission should  
5 instead adopt a FVROR that falls within the upper portion of the range (6.34-6.54 percent) identified  
6 by Staff. Although the Company's brief criticizes Staff's first alternative as being unlawful because  
7 its result is similar to that obtained under the "backing-in" approach, Staff's second alternative does  
8 not share this alleged deficiency. In fact, Staff's second alternative produces \$58,520 more than the  
9 Company was awarded in Decision No. 68176. Ex. S-R3, Smith Direct at Exec. Summary, RSC-3,  
10 Sch. A.

11       When considering Staff's proposed range, the following information may be helpful. The  
12 lower end of this range, 6.34 percent, is the result of Staff's first alternative, which uses a zero cost-  
13 rate for the fair value increment. Ex. S-R5, Parcell Direct at 5. The upper end of the range, 6.54  
14 percent, uses 1.25 percent as the cost rate for the fair value increment. Finally, the FERC method  
15 would produce a FVROR of 6.39. Tr. at 162-64, 352-53. It is appropriate for the Commission to  
16 balance these various results when determining the Company's FVROR.

17 **III. THE COMMISSION SHOULD DENY THE COMPANY'S REQUEST FOR**  
18 **ADDITIONAL RATE CASE EXPENSE.**

19       Staff continues to oppose the Company's request to recover additional rate case expense for  
20 the reasons stated in its Brief, filed on March 5, 2008. Staff's Op. Br. at 12. In short, the Company is  
21 already recovering a normalized level of reasonable and prudent rate case expense through the rates  
22 established in Decision No. 68176. Ex. S-R3, Smith Direct at 20-21. Furthermore, in evaluating the  
23 Company's request for additional rate case expense, the Commission should consider A.R.S. § 12-  
24 348, which prohibited the court from awarding the Company attorneys' fees in connection with its  
25 appeal. The Commission, through the exercise of its exclusive ratemaking authority, may certainly  
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27 <sup>6</sup> The Company has also introduced original cost concepts into the determination of the FVROR. The  
28 WACC is designed to measure the cost of the mixture of capital that underlies the OCRB. Chaparral  
Br. at 24.


1 allow the Company to recover such additional expense if it chooses. However, this result would  
2 appear to be unwarranted in light of A.R.S. § 12-348.

3 In its closing brief, the Company alleged that "[t]he only way for the Company to recover a  
4 portion of the rate case expense it has incurred since the decision was issued in September 2005 is for  
5 the recovery of additional rate case expense to be approved in this proceeding." Chaparral Br. at 45-  
6 46. This statement apparently acknowledges that the Company's pending rate case, which has a year-  
7 end 2006 test year, provides an opportunity for the Company to recover some of these expenses and  
8 to do so in the context of an audited rate case. This would be a far more appropriate context for  
9 considering these issues than the present case.

10 **IV. CONCLUSION.**

11 Staff recommends that the Commission adopt a FVROR that falls within the range identified  
12 by Staff, 6.34-6.54 percent. Staff also recommends that the Commission reject the Company's  
13 request to recover additional rate case expense.

14 RESPECTFULLY submitted this 21<sup>st</sup> day of March, 2008.

15  
16   
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21 of the foregoing were filed this  
21<sup>st</sup> day of March, 2008 with:

22 Docket Control  
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